1812

The National City Bank of New York

Est. 1812

1943

Economic Conditions
Governmental Finance
United States Securities

New York, February, 1943

General Business Conditions

THE developments on the war fronts during the past month have again been encouraging. The great Russian successes and the feat of the British Eighth Army in driving Rommel's forces from Libya, covering almost 1,500 miles in a little more than three months, give support to the view that the start of these offensives in November, together with the occupation of North Africa and our naval victory in the Solomons, marked the turn of the war. Our own forces in the Southwest Pacific also have won new victories, and the period of inactivity in Northern Tunisia enforced by the rains is being well employed in preparation for the next offensive. It will naturally be some time before the decisions taken at the Casablanca meeting are known, but it is safe to assume that the purpose is to initiate the greatest possible effort at the earliest possible date, and to make the most effective use of the resources of the United Nations to that end.

Meanwhile the Russian gains have placed the German armies in a critical position, and the Nazi officials have been forced to prepare the German people for announcement of great defeats and great losses. The dispiriting effect of the Axis reverses on the Axis people may be one of their most important consequences. In the worst days of our own reverses we knew that time would run in our favor, but in the enemy countries the contrary is true.

In 1918 the German effort to win the war before time ran out led to a desperate offensive on the Western front. Now Germany must again make the greatest effort of which she is capable, in the hope of achieving a deadlock by prolonged resistance and by forcing the Allies to pay a terrible price for victory. But Germany is now on the defensive. Her 1942 campaigns have brought her more strategic losses than gains, and have cost her men by the hundreds of thousands and inestimable quantities of material. Her chief reliance to turn the war again in her favor is now on the submarine. Authorities agree that the submarine offensive is gravely dangerous for the Allies, and that it will prolong the war. But the ultimate fortunes of Germany are staked on it.

Interest in opinions as to the length of the war is naturally widespread. Actually, few business men could, if they would, change their present policies materially even if the defeat of Germany within twelve months were reasonably assured. Manufacturers can think and plan for the post-war situation, but until the end of the war the needs of the war must have priority above everything else. Merchants also can do little but move with events. For the most part their buying is governed less by what they would like to have than by what they can get, and the principal merchandising problems are the war-time problems of obtaining goods, maintaining personnel, and functioning under government regulations, rather than of selling.

The Industrial Situation

In important respects the industrial situation is coming into more satisfactory shape. The proportion of the country's effort devoted to war purposes is still growing, as it must. According to an estimate by the Department of Commerce, 55 per cent of industrial production in 1942 was for war purposes. This will be raised to something like two-thirds, out of a greater total production, in 1943.

Also, more progress is being made in the coordination of the productive effort. Changes made in Washington in recent months have inspired confidence, and teamwork between business and government is smoother. The elements in Washington which for a long time had freely expressed their distrust for "big business men" as a group and for industrial policies in general have been less voluble, for the production achievement has given an answer to their criticisms; and the revelation that business organization and experience are vitally needed is either bringing a change of heart, or pushing into the background the type of castigator who was animated chiefly by prejudice. The disposition to rely on the business organization, and to deal with it in a spirit of trust,

is increasing. Changes of personnel in the agencies directing the war effort have brought new men of experience and outstanding ability into prominence, less suspicion is directed at their motives, and more weight is given to their views.

Although it will change in detail continually, the general pattern of the war economy is now to be considered as virtually completed. Mr. Nelson, Chairman of the War Production Board, said as much in a press interview January 21st, when he stated that the point has been reached where little more can be gained in the way of saving materials for war production, by further trimming of the civilian economy. This does not signify of course that supplies of civilian goods have yet dropped to the minimum, for the country is now living partly on its heavy inventories and there are other factors, in addition to the limitation orders of the W.P.B., that will restrict civilian goods production. These include manpower difficulties, abnormal labor turnover and wear and tear on machinery.

In general, however, the problem has shifted from one of cutting off more consumer goods to improving organization of production and obtaining a more effective use of the materials we have. Mr. Nelson said that the three principal problems of the War Production Board are to get increased output of component parts for war weapons, proper distribution of available materials, and simplification of consumer goods. To this he added, as a fourth and less pressing problem, increased concentration of civilian industry, to carry on its reduced operations in fewer plants. Few specific orders for simplification of consumer goods have been issued recently, but programs are being drawn up and announcements reducing numbers of models and governing specifications are to be expected in more lines.

Labor Turnover and Absenteeism

Mr. Nelson did not refer, in his enumeration of present industrial problems, to the need of raising the efficiency of the labor force, which is largely outside his jurisdiction. In more and more plants, however, abnormal labor turnover and abnormal absences from work constitute a major problem holding down production. In September and October, the latest months for which reports of the Bureau of Labor Statistics are available, the monthly separation rates in manufacturing industries were 8.10 and 7.91, respectively, out of each hundred workers. The rates were substantially higher than in earlier months of 1942, and far above those of previous years, and they were mostly voluntary "quits". At these rates, the equivalent of nearly the entire labor force would turn over within one year. Possibly there is no remedy for many of the "quits" short of labor freezing, which would present other problems.

With respect to absenteeism, a survey covering 181 companies made by the Associated Industries of Cleveland January 11 showed reduced absences as compared with a similar survey in November, but the number was still almost double what is considered normal. Probably the greater employment of women, many with household responsibilities, and of workers who are physically less fit, together with the concentration of effort which the war work requires, make an increase in absences unavoidable. But employers also say that absenteeism has increased as workers' pay increased and as the things they would like to buy, such as automobiles and other durable goods, became less available.

In any event, excessive absences are causing a reduction in man-hours which the country cannot afford. They are evidence that to some people the war is still a long way off. American workers are as conscientious and responsive as anyone, and deserve their full share of credit for the great production accomplishment. If those among them who are thoughtless or heedless can be inspired to a greater realization of the supreme effort now needed, the production achievement will be still more impressive and the war will be shortened.

The National Industrial Conference Board has recently published a study which shows that from the start of the war through 1941 output per man-hour in manufacturing increased sharply, but the rise was stopped in 1942, doubtless because abnormal turnover and employment of less experienced workers offset gains in labor-saving methods. Meanwhile wage rates have been advancing and labor cost per unit of product in 1942 was 12 per cent over 1941 and 20 per cent over 1939-40. This rise in costs is likely to continue in 1943. It is a danger to price stability during the war and to the ability of the industries to sell goods at a profit and give employment after the war.

Trend of 1942 Corporate Earnings

Publication of annual corporate reports for 1942 began late in January and only a limited number have become available as yet. In the manufacturing industries, the early reports indicate that, despite the new high records of business volume reached last year, the net income declined in a majority of cases because of higher operating costs and higher taxes.

Six of the big steel companies which have reported new high levels in production last year all show a decrease in net income as compared with 1941, the combined total for the group being down 34 per cent. Reserves for federal income and excess profits taxes absorbed 59 per cent of the net income before taxes in 1941, and 76 per cent in 1942.

A group of 425 manufacturing companies, most of which closed their fiscal year prior to

December 31 and hence were subject to the increased rates of the 1942 Revenue Act only since July 1, show a decrease in 1942 net income of 13 per cent as compared with 1941.

Our regular tabulations showing by major industrial groups the comparative results in 1941 and 1942, based on all reports available by the first of March, will be given in the Bank Letter at that time.

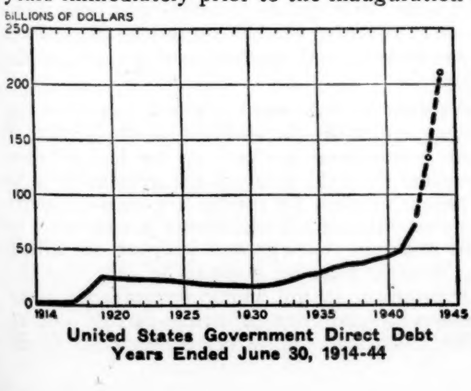
A One Hundred Billion Budget

In transmitting to Congress the new budget of over $100 billions for the fiscal year 1944 the President referred to the budget presented a year ago as "an instrument for transforming a peace economy to a war economy." The present budget, he said, "presents the maximum program for waging war."

That the program set forth does indeed approach, if not reach, the maximum will hardly be questioned by anyone viewing the enormous totals involved, which are summarized, with comparisons for previous years, in the following chart and table. The figures do not include about $4.8 billions of extra-budgetary expenditures by government agencies in 1944 which will bring total expenditures to $109 billions.

Figures on the growth of war expenditures reflect the expansion of the armed forces and the amazing productivity of American industry now reaching full stride in the output of war materials of all kinds. For 1944 the total war expenditures (including $2.7 billions disbursements of government corporations for war purposes), estimated at practically $100 billions, amount to over thirteen times the total for 1941, the first year of the defense program, and compare with $14 billions in the peak year of World War I reached in 1919.

Revenues of the Government are likewise undergoing extraordinary increases, due to record-breaking taxes and swelling national income and business transactions subject to tax. For 1944 the estimated total net receipts of $33 billions at present tax rates are more than four times the total for 1941 and nearly six times the annual average collections of the years immediately prior to the inauguration of the defense program. While these unprecedented increases in revenue have been somewhat overshadowed in the public mind by the still greater growth of expenditures, the evidence afforded as to the quantity of revenue the economic system is capable of producing, when going at full steam, is impressive and has an important bearing upon problems of post-war debt and taxes.



United States Government Direct Debt Years Ended June 30, 1914-44

With expenditures far outstripping even the great gains in revenue, the deficit has mounted enormously and for the fiscal year 1944 is projected at $71 billions, not including government agency transactions. In consequence of these repeated and increasing deficits the direct public debt is estimated to reach approximately $135 billions at the close of the current fiscal year and $211 billions on June 30, 1944. The $3 billions estimated for interest alone on the public debt in 1944 is almost as large as the annual total government expenditures for all purposes in the 1920s.

The Problem of Production

Carrying out of this vast program is first of all a production and organization job. While the budget is expressed in dollars, the real objective is the tanks, guns, ships, airplanes, etc., and the trained fighting forces, that can

United States Government Receipts and Expenditures
(In Millions of Dollars)

Year Ended June 30	Total Net Receipts	Net Expenditures: National Defense	All Other	Net Total	Net Surplus or Deficit
1914	$ 735	$ 263	$ 472	$ 735	$ ...
1915	698	268	493	761	—63
1916	783	286	448	734	+48
1917	1,124	1.452	526	1,978	— 853
1918	3.665	10,838	1,859	12,697	— 9.033
1919	5,152	14,444	4,071	18,515	—13,363
1920	6,995	2,718	3,685	6,403	+ 292
1921	5,625	1,767	3,349	5,116	+ 509
1922	4,109	888	2,485	3,373	+ 736
1923	4,007	675	2,620	3,295	+ 712
1924	4,012	603	2,446	3,049	+ 963
1925	3.780	626	2.437	3,063	+ 717
1926	3,963	599	2,499	3,098	+ 865
1927	4,129	614	2,360	2,974	+ 1,155
1928	4,042	643	2,460	3,103	+ 939
1929	4,033	698	2,601	3,299	+ 734
1930	4,178	721	2,719	3,440	+ 738
1931	3,190	667	3,004	3,671	— 481
1932	2,006	664	3,871	4,535	— 2,529
1933	2,080	651	3,213	3,864	— 1,784
1934	3,116	578	5,433	6,011	— 2.895
1935	3,800	726	6,284	7,010	— 3,210
1936	4,116	940	7,726	8,666	— 4,550
1937	5,029	967	7,210	8,177	— 3,148
1938	5,855	1,066	6,173	7,239	— 1,384
1939	5,165	1,251	7,456	8,707	— 3,542
1940	5,387	1,711	7,287	8,998	— 3,611
1941	7,607	6,301	6,409	12,710	— 5,103
1942	12,799	26,011	6,385	32,396	—19,597
1943†	22,976	74,000	6,432	80,432	—57,456
1944†	33,081	97,000	7,124	104,124	—71,043

Expenditures exclude net appropriations to old-age insurance trust funds, while corresponding social security taxes, also the post-war credits for excess profits tax and Victory tax, are excluded from net receipts. Expenditures exclude sinking fund for debt retirement, and net outlays of government agencies. National defense total excludes expenditures charged to War Department for rivers and harbors, and flood control; also for Panama Canal; but include loans to foreign governments in 1917-21 and lend-lease in 1941-44. †Budget estimate.

meet the enemy in battle. The immensity of the production effort required may possibly be brought home more forcibly by considering for a moment the meaning of a hundred billion dollars of war expenditures.

In 1929, our greatest boom year before the war, the total gross output of goods and services of all the people was estimated at about $99 billions. To reach the volume of war spending contemplated in the budget means, therefore, that we shall have to produce for war alone a sum total of goods and services about equal to the total national product of our busiest peace-time year. And we shall have to do this while at the same time supplying the non-war needs of the federal government, the needs of the local governments, and the essential requirements of a civilian population of more than 120,000,000.

The budget message of the President gives recognition to this aspect of the problem. It begins with the broad characterization of the budget quoted above, and passes immediately to a discussion of problems of manpower, of equipment, of raw materials, food, and the like, stressing repeatedly the need for hard work, saving, and increased efficiency. "Victory," said the President, "cannot be bought with any amount of money, however large; victory is achieved by the blood of soldiers, the sweat of working men and women, and the sacrifice of all people." One of the lessons being learned in war, worth carrying over into peace, is that the things that people really want cannot, as the President said, be bought with any amount of money; there has to be production to supply the goods on which the money can be spent.

Though the program is gigantic, yet the President expresses confidence that it can be carried out. And the performance to date supports him in this view. A year ago the President's request for 60,000 airplanes, 45,000 tanks, and other arms and ships in proportion, for the calendar year 1942, was regarded by many as fantastically high; yet not only were these individual goals closely approached or exceeded, but the over-all program went far ahead of even the President's expectations. The original budget estimate of $53 billions of war expenditures for fiscal '43, presented to Congress in last year's budget message, has had to be raised repeatedly and is now estimated at $74 billions.

To do the job will be no easy task, but will require, as the President said, the full harnessing of the nation's manpower and resources. Obviously we cannot do it unless many now unemployed are employed, women are brought into industry, and those who are producing work longer hours and more effectively.

Not only will the job require a great national effort, but also great national restraint. The civilian population will have to get along with less. The President brought this down to individual terms by stating that there would be available for civilian purchases during the coming year an average of about $500 worth of goods and services, implying a reduction of about 25 per cent in average civilian consumption below the record level of the calendar year 1941. And this at a time when income payments to individuals, taken in the aggregate, will be higher than ever before.

No Room for Waste

With demands upon productive capacity and costs to the taxpayer so great, there is no room for any waste that can possibly be avoided either in the war program or in routine government operations.

One kind of waste is maintenance of too high a level of non-war expenditures by the federal and state and local governments. While the new federal budget places non-war expenditures (excluding interest and statutory debt retirement) at $4,124 millions for fiscal '44, down $458 millions from the present fiscal year and $2.4 billions since 1939, economy-minded members of Congress have expressed the conviction that further reductions are possible. The principal economies to date have come in the reduction or elimination of relief agencies brought into being during the depression, including the W.P.A. which in the past ten years has spent $10 billions and is to be wound up this year. On the other hand, the largest item in the budget, outside of war activities and debt interest, is $889 millions for "aids to agriculture," despite the tremendous expansion of farm income to the highest level ever reached.

Special economy committees headed by Senator Byrd and Senator Tydings have undertaken a thorough scrutiny of all departmental and agency requests, as well as the extent to which reductions may have been brought about merely by the transfer of some activity from a "non-war" to a "war" designation. In the House, the Civil Service Committee under Chairman Ramspeck has begun an investigation of complaints as to widespread overstaffing of government departments and agencies by civilian employes. The President in his budget message expressed willingness to cooperate with Congress in effecting further reductions in non-war expenditures, and further savings are to be hoped for.

Another form of waste is extravagance in the war expenditures themselves, which in view of their overwhelming share of the budget now represent the field in which the greatest watchfulness is needed. Of course the country wants to spend without stint whatever is necessary to fight and win the war and support our allies. At the same time we want to be sure that the war program is not being encumbered with unessential activities or being carried out at lavish costs that ignore the tremendous finan-

cial burden which the program as a whole is placing upon the people. The continuing subsidies to agriculture and failure to limit price advances of farm products, the raising of industrial wages, the requirements for time and a half pay for all work over forty hours, strikes and labor union restrictions upon output, all have the effect of increasing the cost of the war and in many cases of actually impeding war production. Excessive profits by industry are equally costly to the war program, but where they occur they are being dealt with through renegotiation of contracts and by excess profits taxes running up to 90 per cent.

Still a third form of waste is bad planning of the war program itself, so that we make too much of some things and too little of others, or fail to coordinate production with raw material supply and transportation facilities. The controversy now existing over the proper size of the Army, relative to the need for manpower for industry and agriculture and to ability to transport and supply the armed forces overseas, represents a major phase of the problem of planning which if not handled wisely will involve tragic waste. These are indeed difficult problems, and with the needs constantly changing it is obvious that some waste will be inevitable.

Figures given in the President's message reflect the changing character of the war program; they provide for an increase in munitions expenditures from $43 billions in the fiscal year 1943 to $66 billions in fiscal 1944, with an increase in military and civilian pay, subsistence and travel from $15 to $21 billions, while military and other construction will be cut in half from $14 billions to $7 billions. Congress and the various government planning and purchasing departments will need to exercise continuing careful judgment to hold military production schedules, commitments, inventories, etc., within the realm of reasonable possibilities as to usefulness and transportation facilities.

Raising the Money

Secondary only to the problem of production and organization of the $100 billion war program is the financing problem. This problem was summarized concisely by the President in the budget message as follows:

> **Financing total war involves two main fiscal problems. One problem is to supply the funds currently required to pay for the war and to keep the increase in federal debt within bounds. The second problem is caused by the disbursement of 100 billion dollars a year to contractors, war workers, farmers, soldiers, and their families, thus adding many billions to the people's buying power, at a time when the amount of goods to be bought is declining steadily.**
>
> **A large portion of this excess buying power must be recovered into the Treasury to prevent the excess from being used to bid up the price of scarce goods and thus undermine the stabilization program by breaking price ceilings, creating black markets, and increasing the cost of living.**
>
> **We cannot hope to increase tax collections as fast as we step up war expenditures or to absorb by fiscal measures alone all excess purchasing power created by these expenditures. We must, therefore, provide a substantial portion of the needed funds by additional borrowing, and we must also use direct controls, such as price ceilings and rationing, for the protection of the consumer.**

The President concluded that we should strive to collect "not less than $16 billions of additional funds by taxation, savings, or both," during the fiscal year 1944. If this could be done, it would mean that we would be collecting currently about one-half of total expenditures.

Everyone recognizes the need for collecting currently as much as possible, but there will be differences of opinion as to how large an increase in taxes and compulsory savings at one time is practicable on top of the drastic tax increases that have been imposed in recent years. It is true that incomes in the aggregate are increasing at an annual rate which is greater than $16 billions, but the difficulty is that the income increases are not distributed evenly — some people have had large increases, some have had no increase, and some have had decreases. This unevenness in changes among individual incomes places limits upon the amount of additional taxes that can be levied.

In determining what kinds of taxes are needed, the conclusion would seem obvious that to obtain large amounts of money it is necessary to go where the money is. The principle has long been recognized in business that to build large distribution requires the pricing of products within the income range of the great mass of the people. The principle would seem to apply equally well to collecting taxes, when the need is to obtain large amounts of revenue and to recapture the inflationary purchasing power poured out by Treasury disbursements and going largely into industrial payrolls and farm income, which in the three years 1939-42 increased by 134 per cent and 118 per cent, respectively

One means of distributing the tax burden as widely and fairly as possible is to employ a variety of taxes. The tax increases voted in recent years have relied to an increasing extent upon direct taxes upon individuals and upon the corporations. As shown by the summary on the following page of the distribution of federal tax receipts, the percentage derived from direct taxes upon individual and corporate incomes will in the five years 1939-44 have increased from 47 per cent to over 80 per cent. In the same period, the portion from excise, manufacturers', customs and other indirect taxes will have declined from 36 to 12 per cent.

With so heavy a reliance upon direct taxes, the introduction of a general federal sales tax, which has been repeatedly considered, would not only provide substantial additional revenue but would tend to round out and give better balance to the tax structure. It would reach

Principal Sources of U. S. Government Revenue Receipts — Fiscal Years Ended June 30
(In Millions of Dollars)

Source	Actual 1939	Estimate 1944	Percentage of Gross Receipts 1939	1944
Direct taxes on individuals	$1,422	$13,751	25.1	38.8
Direct taxes on corporations	1,248	14,915	22.0	42.1
Liquor taxes	588	1,486	10.4	4.2
Tobacco taxes	580	948	10.2	2.7
Other excise & mfrs' taxes	583	1,482	10.3	4.2
Employment taxes	740	1,982	13.1	5.6
Customs	319	204	5.6	0.6
Miscellaneous receipts	188	639	3.3	1.8
Gross receipts	$5,668	$35,407	100.0	100.0
Deduct:				
Old-age ins. trust fd.	503	1,525	8.9	4.3
Post-war credits for excess profits tax and Victory tax	....	800	....	2.3
Net receipts	$5,165	$33,082	91.1	93.4

millions of people now affected lightly, or not at all, by direct taxes. Since the tax is paid in small amounts at a time, and only on income spent, it would be less burdensome in many respects than taxes that must be paid in lump sums on gross or net incomes.

In discussing the principles that should govern a well-designed tax system, Roswell Magill, professor of law at Columbia University and former Under Secretary of the Treasury, in an informative book on "The Impact of Federal Taxes" (Columbia University Press, New York, 1943) states:

> If we really want to head off inflation, selective taxation is an intelligent means to the end. "Selective," because not all taxes operate to stem the tide of increasing incomes bidding for consumer goods. Thus, our corporation taxes are exceptionally heavy, yet they are of secondary use in narrowing the so-called inflationary gap, for corporation income is not much used to bid for scarce articles of consumption. A sales tax operates directly to cut down purchasing power *pro tanto;* and so do income taxes.
>
> Since the great increases in income have been at the lower levels, on this score an increase in the normal tax rather than increases in surtaxes is indicated. England has followed this course, with a normal tax of 50 per cent (as compared to our 6 per cent normal tax and 13 per cent surtax) except at the very bottom of the scale, where the rate is 32.5 per cent.
>
> There has been much discussion of a general sales tax, collected either from manufacturers or retailers. It would produce a great deal of money, though not so much, perhaps, as some of its advocates would like to believe. Still the Treasury tells us that a 5 per cent tax on all retail sales (except sales to government) would yield $2.5 billions.
>
> The Treasury has objected to a sales tax on grounds of tax equity and administrative difficulty — questions to be considered later. But whatever the demerits of a sales tax in these respects, the Treasury has found it hard to convince a thoughtful citizen that it is intensely concerned about the adequacy of its tax revenues, when so great and so obvious a source is passed by.

Pay-As-You-Go Taxes

With the approach of March 15, the date for payment of the first instalment of the record-breaking 1942 personal income taxes by millions of people most of whom heretofore have not been subject to this tax, the need for getting tax collections on a pay-as-you-go basis has become the most immediately pressing issue in the whole tax question. Popular demand for such a plan has been sweeping the country as people have come to realize more fully the substantial quarterly payments for which they are liable. Treasury officials have expressed themselves as favoring the pay-as-you-go principle, with collections at the source, and the only real problem has been that of getting the taxpayer on this basis without having him pay two years' taxes in one.

The plan that has been suggested of treating current tax payments as applying to 1943 income instead of 1942, commonly spoken of as "forgiving a year's taxes," has been widely misinterpreted as meaning that taxpayers would pay less taxes and the Treasury would lose a year's revenue. Actually, of course, there would be no hiatus in tax paying. Taxpayers would go on paying taxes and the Treasury would go on receiving its revenue, only the taxes would apply to this year's income instead of last. Since incomes in the aggregate are expected to be larger this year than last, the taxes paid this year under a pay-as-you-go plan would be actually larger than otherwise. Regardless of what plan is adopted, Congress will be determining each year the Treasury's needs and levying taxes for as much as it thinks the country can pay, so that there is no reason to suppose that the so-called "skipping a year's taxes" would mean any less tax in the aggregate.

The great advantage to the taxpayer, however, of pay-as-you-go (or pay-as-you-earn, to put it more accurately) would be that of being continuously up to date in his tax payments. He would be paying his taxes when he has the money, instead of paying them a year after his income had been received and the money may have been spent. The advantage to the Treasury would be in having the taxes collected immediately and at the source from the rising levels of incomes, and in the avoidance of widespread delinquencies and evasions which seem certain to result from the year's lag under the present system.

According to the results of a Gallup Poll published last November, 75 per cent of the number of persons questioned reported that they had not started saving any money for the purpose of paying their March 15 income tax. In the lower income groups, which include the great bulk of the new taxpayers, the percentage not saving was 85. While tax consciousness has increased a great deal since that time, there are doubtless still millions of people who have made no provisions for such payments, and many have not even determined the extent of their tax liability.

This lack of preparedness on the part of large numbers of taxpayers, together with the desira-

bility of collections at the source where large numbers of small income returns are involved, makes imperative early action to put the tax system on a current collection basis. Unless, however, the changeover can be made in a way that avoids "doubling up" on the taxpayer, many individuals will have great difficulty in making their payments.

Financing the Deficit

Finally, there will remain after current taxes a deficit to be financed through borrowing of approximately $57 billions for fiscal 1943 and $71 billions for 1944. The latter, even on the basis of $16 billions added taxes, would still amount to $55 billions, or to $58 billions including agency transactions.

The principle must be to finance as large a part of this borrowing as possible outside of the commercial banks, whose purchases of government securities result in expansion of bank deposits and are definitely inflationary in character. This means intensifying the drive to sell securities of appropriate kinds and maturities to the wide and varied groups of potential buyers, including the insurance companies, savings banks, business corporations, investment trusts, and especially to the millions of individuals who are receiving the increased income generated by the war program.

Large numbers of workers in the industries have experienced income increases so great that it would be impossible to frame any new tax to recapture enough of this increment without such taxes being unbearable by others whose incomes have had little or no increase or have actually decreased. This situation can be met by an intensified appeal to these groups for voluntary purchases of war savings bonds. If successful this would have the double advantage of diminishing inflationary spending power at present, and providing the buyers of such securities with a backlog of savings and purchasing power against the uncertainties of the post-war period.

Trend of State and Municipal Finances

A year ago in discussing the need for governmental economy we observed that "the states and municipalities can likewise play their part by practicing economy and utilizing increased revenues either to retire debt or reduce taxes and thus help clear the way for a federal tax program and strengthen their own positions."

As forty-two of the forty-eight state legislatures are now in session and preparing budgets for the succeeding fiscal periods, it is possible to review the experience of the states during the country's first year at war.

It is apparent from a broad sampling of year-end reports that with few exceptions the state governments are in stronger financial position than for many years past. Tax yields have risen, while demands for relief have lessened and capital expenditures have been curtailed by priorities and lack of manpower. This prosperity seems to be general, although relatively greater in the states embracing both large-scale agriculture and war production. Gasoline rationing effective along the eastern seaboard during the greater part of the year caused those states a loss of motor revenues, but in some sections this was substantially or completely offset by the rise of sales, franchise, and income tax yields reflecting the generally better level of business.

Aggregate cash on hand reported by a group of eighteen states approximates the unusually large amount of $500 millions, and there is good reason to believe that the total for all the states is nearly double that sum.

Rather than holding out any general hopes that this abundance of cash may enable the states to lower their tax rates, the majority of the budgetmakers are adopting a cautious viewpoint. They appear to feel that it would be better policy to maintain present taxes against the possibility of falling revenues, and to use surpluses for balancing budgets, for accelerating debt retirement, and for post-war reserves. They appreciate that rationing of civilian consumption may considerably reduce revenues from sales taxes, and that problems now only vaguely foreseen may develop rapidly in an economy dislocated by an all-out war effort.

State budget executives who have already made definite recommendations on this subject are about equally divided in favoring accelerated debt retirement or provision for post-war work programs, and several have urged that surpluses be divided between these purposes. At least three states — New York, Massachusetts and Maryland — have changed or are proposing to change their fiscal year dates in order better to synchronize income and expenditure; and the necessary adjustments will probably absorb considerable amounts of their year-end surpluses. Several states (notably Pennsylvania) will improve their current positions by retiring debt representing deficiencies inherited from previous administrations; and Vermont proposes to appropriate $1 million reserve against an estimated $3 millions liability, under a 1941 act providing payments up to $120 to returning service men after the war.

With few exceptions tax rate increases can be avoided, despite broadening social security commitments, rising salary and wage levels, higher materials costs and the generally anticipated decline of highway revenues. The few states that may consider reduction of tax rates include California, Ohio, Pennsylvania and others whose revenues are running considerably ahead of present or anticipated requirements. The taxes which would be reduced include income, sales and miscellaneous levies

that were originally adopted to finance relief expenditures.

In general there seems to be little prospect of state tax reduction. It is encouraging, however, that so many of the state budgetmakers are treating their extraordinary surpluses conservatively, making due provision for the protection of their credit. Of course the legislatures must make the final decisions and it is to be hoped that they will combine the best features of these executive proposals with all possible economies.

It is difficult to state any general conclusions about the municipalities' financial trends because of the greater variety of their problems, but there is the comforting consideration that state and local government debts alike are being slightly reduced. State debt is down nearly $250 millions from the peak recorded in 1940, to an estimated $2,707 millions net after sinking funds on June 30, 1942; while local debt is off by $350 millions from the peak of 1941, standing at $14,964 millions net after sinking funds on June 30, 1942. In the twenty years from 1922 to 1942 net local debt increased by 93 per cent and net state debt by 189 per cent, the combined net by 103 per cent. Annual interest requirements, however, rose but 58 per cent over the same period, as a result of the almost steady lowering of interest rates since 1932.

Capital programs now being prepared by many states and municipalities for the post-war period may reverse this trend, but meantime the curtailment of state and municipal borrowing has been sharp. In 1942, the Commercial & Financial Chronicle recorded a total of $523 millions of capital issues, including both new money and refunding, down from $952 millions in 1941 and $1,233 millions in 1940. The peak was $1,500 millions in 1927. As an indication of the immediate prospect, the electorate in 1942 elections voted approval of less than $100 millions state and municipal loan authorizations, in contrast with $783 millions approved in 1928.

Problems of Food Price-Fixing

Problems of food supply and distribution are new in this country. In normal times Americans have found at every corner grocery store an abundance and variety of foods drawn from all over the world. The system of production and distribution worked so effectively that apart from those engaged in it few paid it conscious attention, or gave thought to its scope and complexity. In fact, the working of the system itself was almost automatic, for it was guided not by an overhead authority but by the fluctuation of prices, which reflected consumers' wants and producers' responses and directed effort accordingly.

All this is being changed by the impact of war. Civilians will have enough food for a healthy and balanced diet, but not the variety and choice of the recent past. Secretary of Agriculture Wickard, now Food Administrator, states that military and lend-lease requirements for food will take 25 per cent of this year's maximum probable production. If the crops are poor it will be the civilian supply that is reduced. If the Allies reoccupy parts of southern and western Europe in 1943 the Government's requirements probably will be still greater.

Meanwhile the system of food production and distribution, instead of being guided by freely fluctuating prices, is being dominated increasingly by overhead regulation. Farm programs are planned in Washington even more than heretofore. Support of prices through loans and purchase programs, plus benefits and bonuses, are provided to induce farmers to conform. Distributors' prices are fixed and quotas set, and consumers will be increasingly rationed.

Regulation vs. Free Price Movements

Under ordinary circumstances the presumptions would be all against elaborate control of food prices and distribution, but few question the need under present conditions. The alternative is to allow free competitive bidding among people and between Government and people. Such bidding would balance demand and supply, but its practical result would be an unbridled rise in the cost of living and disastrous inflation. Moreover, it would hardly accomplish the most equitable and effective distribution of food, for purposes of the war effort and of public health.

In seeking the benefits of control, however, the problems and disadvantages of government regulation also have to be faced. When the guidance of natural price changes is abandoned there is hardly any end to the regulation that becomes necessary, for solutions of one problem create others, and establishment and enforcement of controls so that they will accomplish the desired purposes involves difficulties that are hardly less forbidding than those of a free market. Prices have an influence upon consumption, and if price advances are no longer to be relied upon to reduce consumption, some other mechanism must be substituted. This other mechanism is rationing. The public is now familiar with the problems of devising simple, fair and effective rationing.

In fixing prices the authorities must reconcile a basic conflict. It is desirable to keep prices down to suppress inflation, but it is also desirable to allow them to advance where higher prices would stimulate production. This is serving two masters, — and in a field where price relationships are so complex that even the most conscientious and able administrator can hardly

foresee all the effects of arbitrary interference. Moreover, the task is complicated by the fact that the power to fix food prices at the producer level, which is held jointly by the Price Administrator, now Mr. Brown, and by Secretary Wickard has been narrowly limited by Congress, through the definition of minimum levels below which ceilings on farm products may not be set.

In part because of these limitations, and in part because of a conscious policy of allowing price advances to encourage production, only three farm price ceilings — burley tobacco, corn and alfalfa hay — have been set at the producer level. The ceiling on corn is not for the purpose of discouraging corn growing, but to encourage livestock feeding; and as most corn growers in the Corn Belt are also feeders, what matters most to them is what they get for their corn "on the hoof."

On the other hand, ceilings at the processing or distribution level have become more and more numerous. With the exception of perishable products, the "freeze" of food prices at this level became general in October. Thus price ceilings are set on flour, bread and macaroni but not on wheat; on pork and beef products but not on hogs and cattle; on milled rice but not on rough rice.

Situation of Processors and Distributors

This type of price fixing lays some restraint upon the rise of producers' prices, but its principal effect is upon processors and distributors. Their selling prices are fixed, but their buying prices are free and in many cases have risen since the ceilings were established. Thus margins are squeezed. Meanwhile operating costs have advanced. Physical difficulties have increased, such as shortage of equipment for processing the increased volumes, necessity of making changes in packages and containers due to tin conservation, diversion of tank cars from the vegetable oil trades, and others. Over all is the problem of maintaining the labor supply, both in quantity and quality.

Food processors and distributors are vulnerable to these squeezes. The task of converting farm products into food and distributing it when and where needed is performed by a highly efficient and strongly competitive industry which operates on the basis of large volume, rapid turnover and low profit margins. The initial price freeze, in the general maximum price regulation which took effect last May, involved hardship for many in the food trades, which reacted upon the consumer. The regulation froze prices and margins which were unprofitable as well as those which were profitable. It penalized distributors who had kept prices down as against those who had been getting all the market could bear. By its nature it could take no account of changing costs.

Unprofitable items accordingly began to disappear from the "low price" stores whose margins were low at the time of freezing, and foods that were scarce were diverted from lower price to higher price areas. Mr. Paul S. Willis, President of the Grocery Manufacturers of America, stated in August that "over 400 grocery items have a replacement cost for distributors which is out of balance with their frozen ceiling prices." In October a press release from the Office of Price Administration said:

> **The effects of this price squeeze * * * have already been felt at the "shopping" level in hundreds of thousands of stores. Many shelves have already been emptied of nationally known food items. Canned vegetables and canned fish especially have been disappearing rapidly as retail and wholesale inventories * * * have become exhausted.**

Thus it has been necessary to provide relief, to enable the food trades to perform their function. Subsidies were paid at an early date to cheese manufacturers, vegetable oil crushers, and small meat packers, and these are being continued. More important was the upward revision of price ceilings in October in a number of products including canned goods, breakfast cereals and shortenings. This action, taken to reflect the higher costs of the 1942 crops as well as wage increases, restored many items to "low price" store shelves; and it was followed early in the past month by other ceiling increases, to widen distributors' margins.

To lift these ceilings was the only feasible policy, barring subsidies, but the action raises another basic question, namely, how far can advances be permitted without nullifying the price-wage stabilization efforts, and starting a new inflation spiral?

The policy of the O.P.A. now is to abandon March, 1942, prices as the ceiling yardstick and substitute dollars and cents ceilings at the processing level with fixed mark-ups for distributors. This move, however, by no means disposes of the problem. As prices at the producer level have risen, need for relief has appeared in other areas, and correction of one price inequality has often led to another.

The Flour "Squeeze"

The flour squeeze is a persistent problem, which illustrates the general difficulty. It had its origin early in October when the Office of Price Administration placed a 60 day temporary price ceiling on flour, based on the price of wheat at that time. Soon thereafter, however, wheat prices started to move up, chiefly because some 40 per cent of the 1942 crop moved into the government loan, while farmers at the same time held back wheat in the belief that still higher prices would follow Congressional moves to revise the parity price upward. Gradually, millers ceased taking orders for flour, because ceiling prices no longer covered the cost of wheat, and confined operations to old orders,

on which wheat requirements had been covered at lower prices.

After wheat had advanced some 20¢ per bushel, and stores and bakers in some parts of the country were beginning to run low on flour, O.P.A. permitted a 10 per cent increase in the flour ceiling, which became effective early in January. However, farmers continue to hold their wheat for still higher prices. Until the wheat price rises to parity, the authorities have no power over it. At parity, the Commodity Credit Corporation can, and has announced that it will, offer wheat to the market. But according to O.P.A. calculations the new flour price ceiling does not permit millers to pay above 89 per cent of parity for hard wheat (bread flour) or 95 per cent for soft wheat (cracker flour). Thus another flour squeeze seems in the making unless farmers turn liberal sellers. The story is one of trade disruption, almost leading to artificial shortage, although nearly two years' supply of wheat is available for this crop year.

Meanwhile the squeeze is passed on to the baking industry which is experiencing difficulty in absorbing not only the higher flour prices, but also the rising replacement costs of shortening and milk, while continuing to sell its products at price ceilings established last March. In New York City, small bakers were recently unable to buy flour because jobbers froze their flour stocks pending an appeal to O.P.A. for a wider margin. Bakers have also encountered difficulty in obtaining the necessary powdered milk to comply with the government's new nutritive standards because powdered milk processors, also faced with a squeeze, have not been selling freely.

Other "Squeezes"

In Southern markets the price of rough rice actually has risen above the ceiling price on milled rice. Ceiling prices have been established for both live and dressed poultry, but live poultry dealers in New York City have protested that the margin is too small. Scarcity of milk has been reported in certain marketing areas where milk prices are not geared to butter prices, because supplies have been drained away to milk sheds where the price of milk has automatically advanced with the rise in butter prices.

Black markets in meats have flourished in the East because retailers have been forced, in order to obtain supplies, to buy and sell above ceiling prices. Meanwhile, hog and cattle prices for a considerable period have been above levels which O.P.A. has indicated slaughterers could afford to pay without incurring loss. Slaughterers have continued to do business in spite of losses in the fresh beef and pork sections, but naturally sell where their returns are best, which means greater scarcity of meat in some areas and for some customers than others.

Cases of maldistribution and black markets are important not only as signs of ineffectiveness in the program, but because they are disturbing to consumers who wish to cooperate loyally, and who are counting upon the Government not only to keep living costs down but to deal equitably with people in doing so. If cooperation is weakened the whole program will be imperiled.

The Food Administration's Objectives

It should be said that the new food administration headed by Secretary Wickard appreciates the difficulties of the food trades, and that a conscientious and energetic effort is being made to establish workable policies. He has the aid of expert business talent from the food trades, and his regional representatives are instructed to seek the help of the trades. In a recent speech delivered at Chicago Mr. Wickard said:

> By and large, I think the food industry is well organized and efficient and, for these reasons, it should be interfered with as little as possible in the execution of a war-time food program. I for one have no intention and no wish to fasten government controls in perpetuity upon the food industry.

The Administration hopes that reduction in distributors' costs through simplification of products and elimination of services will make it possible for them to function on narrower margins. The ban on slicing of bread at the bakery, reduction of container sizes in various lines, and similar moves, are for that purpose. Such measures can help, but their contribution is small measured against the magnitude of the problem.

Within the next month or so, a broad program of "point rationing" will be applied to canned fruits and vegetables, canned soups, dried and dehydrated fruits, and frozen fruits and vegetables. Meat rationing will get under way soon thereafter, and undoubtedly other commodities will follow. The Administration counts upon this to curtail demand, correct maldistribution, and finally to strengthen its hand in the effort to stabilize the cost of living.

The Policy for Producers

The discussion thus far has dealt with the effort to limit prices, for the benefit of the consumer and to suppress inflation. The authorities also have to consider what prices will sustain and encourage production. On the principle that producers' prices must be remunerative, and high enough to act as a stimulus to those having high costs as well as those having low costs, there is general agreement. Farm production is by millions of individuals who naturally respond to the incentive of a greater return for increased work and effort.

In accord with this principle, price "floors" in many cases have been established, supported by government loans and purchase programs.

Benefit payments on the 1943 crops will be conditioned on the extent to which desirable production shifts are made, and producers of potatoes, beans and several other crops will be paid a bonus on normal yields from whatever acreage is planted in excess of 90 per cent and up to 110 per cent of their individual goals. These payments are from the Federal Treasury. The costs will fall finally upon the consumer, but are smaller than if higher prices were allowed on all production. On vegetable crops for canning, subsidies are to be paid on the full production, if Congress appropriates the funds; the plan is complex, involving purchase of canners' output and resale to the canners at a loss, provided they pay growers stated minimum prices.

Members of the farm bloc in Congress and undoubtedly many others, take the view that still higher prices of many farm products are needed to maintain and increase production. They are demanding a revision of the parity formula so that the cost of farm labor, including that of the farmer and his family, may be included in the calculation of the parity price.

This is a proposal which has been made before, and the opposition of President Roosevelt and Secretary Wickard is on record. They fear it as a menace to price-wage stabilization, and consider that it is based on representations which in general are overdrawn. It is always true that higher prices, from any given level, can be expected to increase production, subject to the limits of the ability of the economic system to produce; but the question is whether the cost of bringing in the additional production is excessive.

A Problem of Men and Tools

Consideration of all the elements should support the opinion that—whatever the exceptions — the farm production problem is no longer chiefly a price problem. The principal difficulty of the farmer is to obtain enough labor, machinery, and supplies. Some assume that if prices were higher the labor problem could be solved by paying higher wages, which would attract more workers to the farms. This, however, is to rely upon competitive bidding for labor. Competitive bidding cannot increase the aggregate labor supply; and if the farmers should be successful in attracting workers from the industries what would the airplane plants, the arsenals and munitions factories, which are also essential to the war effort, do for the added workers they will need this year?

From this viewpoint, the problem of increasing farm production is less a problem of price than, as ex-President Hoover said in his address in New York on January 21, of "men and tools." To provide them is chiefly a task for government policy and community effort. Secretary Wickard has a six-point program to cope with the farm labor shortage, referred to in this Letter last November. Within the past month liberalized standards for deferment from military service have been set up by the War Manpower Commission; in some cases, local draft boards now are able to defer farm workers responsible for as few as eight units (acres or dairy cows) of agricultural war production, as compared with the previous standard of sixteen units. Likewise, the W.M.C. has recently given Secretary Wickard responsibility for recruiting from less essential occupations the 3,500,000 additional farm workers which temporarily will be needed at the peak of the 1943 harvest season. Some farmers from sub-marginal land in the South already have been transferred to dairy sections of the mid-West. Agricultural implement production quotas are being revised upward by the War Production Board.

Benefits of Free Price System

Whether or not a smoothly working program of food control is established for the emergency, the unsuitability of the controls for other than emergency use should be evident from the experience, and the difficulties should increase general appreciation of the normal price system. When allowed to move freely, prices almost automatically bring about the necessary adjustments of supply and demand, without need of other controls. If prices are permitted to anticipate needed changes far enough in advance, as through the futures trading system, the actual adjustments may prove less than anticipated.

When overhead decisions are substituted for the impersonal decisions of the market, however, a chain of regimentation is set moving which has no end. In peacetime the problems would be even more complicated, for people are expected to give more willing and wholehearted cooperation to the overhead control in war than would ever be likely in peace. Thus the test of the practicability of such controls is taking place under the most favorable conditions. It should set people reflecting upon the benefits of the system which in the past has provided them with the most abundant and varied food supply of any people in the world.

Meanwhile the problem is to make the wartime measures work. To deal perfectly with all the complexities is manifestly impossible, for many decisions can never do more than compromise conflicting interests. Chief reliance must be upon the practical sense of those in authority, their use of the experience and ability available in the food industry, a readiness to make adaptations as developments require, and finally good teamwork, achieved by patience and cooperation among all concerned.

The National City Bank of New York

Head Office* · 55 WALL STREET · *New York

Condensed Statement of Condition as of December 31, 1942

INCLUDING DOMESTIC AND FOREIGN BRANCHES

ASSETS

Cash and Due from Banks and Bankers		$ 901,172,804.72
United States Government Obligations (Direct or Fully Guaranteed)		1,988,096,539.18
Obligations of Other Federal Agencies		40,685,587.79
State and Municipal Securities		157,477,344.91
Other Securities		41,153,412.88
Loans, Discounts and Bankers' Acceptances		573,450,839.96
Real Estate Loans and Securities		5,463,330.18
Customers' Liability for Acceptances		3,630,238.96
Stock in Federal Reserve Bank		4,650,000.00
Ownership of International Banking Corporation		7,000,000.00
Bank Premises		38,160,040.02
Other Assets		731,142.09
Total		$3,761,671,280.69

LIABILITIES

Deposits		$3,555,940,022.94
(Includes United States War Loan Deposit $639,736,170.89)		
Liability on Acceptances and Bills	$5,949,926.32	
Less: Own Acceptances in Portfolio	1,492,111.72	4,457,814.60
Items in Transit with Branches		9,551,054.28
Reserves for:		
Unearned Discount and Other Unearned Income		2,226,619.25
Interest, Taxes, Other Accrued Expenses, etc.		7,602,319.50
Dividend		3,100,000.00
Capital	$77,500,000.00	
Surplus	77,500,000.00	
Undivided Profits	23,793,450.12	178,793,450.12
Total		$3,761,671,280.69

Figures of foreign branches are as of December 23, 1942, except those for enemy-occupied branches which are prior to occupation but less reserves.

$775,828,298.70 of United States Government Obligations and $13,564,325.62 of other assets are deposited to secure $732,519,799.60 of Public and Trust Deposits and for other purposes required or permitted by law.

(Member Federal Deposit Insurance Corporation)

City Bank Farmers Trust Company

Head Office* · 22 WILLIAM STREET · *New York

Condensed Statement of Condition as of December 31, 1942

ASSETS

Cash and Due from Banks	$ 37,601,929.70
United States Government Obligations (Direct or Fully Guaranteed)	84,914,865.72
Obligations of Other Federal Agencies	646,107.75
State and Municipal Securities	3,571,247.87
Other Securities	1,180,382.42
Loans and Advances	1,208,330.44
Real Estate Loans and Securities	6,672,858.59
Stock in Federal Reserve Bank	600,000.00
Bank Premises	3,672,956.25
Other Real Estate	204,770.94
Other Assets	1,788,263.75
Total	$142,061,713.43

LIABILITIES

Deposits	$115,366,183.01
Reserves	865,427.06
Capital	10,000,000.00
Surplus	10,000,000.00
Undivided Profits	5,830,103.36
Total	$142,061,713.43

$39,341,746.50 of United States Government Obligations are deposited with public authorities for purposes required or permitted by law.

(Member Federal Deposit Insurance Corporation)

K

Y

ted in U.S.A.